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October 19, 1994

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: PR File No. 94-SP4 94-106

Dear Mr. Caton:

Transmitted herewith on behalf of Connecticut Telephone and Communications Systems, Inc. and Connecticut Mobilecom, Inc. (collectively, "Connecticut Telephone") are an original and four copies of its Reply Comments in the above-referenced matter. Please note that certain information in this Reply has been redacted pursuant to the terms of the Protective Order issued by the Department of Public Utility Control ("DPUC") of the State of Connecticut in its Docket No. 94-03-27 (the "Protective Order"). Please note also that the references to the Transcript and Exhibits in the Reply relate to the Transcript and Exhibits in DPUC Docket No. 94-03-27. Connecticut Telephone is not at this time providing copies of any material that may be subject to the Protective Order.

Should there be any questions concerning this matter, kindly communicate with this office.

Sincerely,

Robert B. Kelly

ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Petition of the Connecticut	)	PR File No. 94-SP4
Department of Public Utility	)	94-106
Control To Retain Regulatory	)	
Control of the Rates of Wholesale	)	
Cellular Providers in the State	)	
of Connecticut	)	

To : The Commission

REPLY OF CONNECTICUT TELEPHONE AND COMMUNICATIONS SYSTEMS, INC. AND CONNECTICUT MOBILECOM, INC.

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October 19, 1994

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REPLY OF CONNECTICUT TELEPHONE AND COMMUNICATIONS SYSTEMS, INC. AND CONNECTICUT MOBILECOM, INC.

The undersigned, Connecticut Telephone and Communications Systems, Inc., and Connecticut Mobilecom, Inc., both Connecticut corporations doing business in the State of Connecticut (hereinafter referred to collectively as "Resellers"), respectfully submit to the Federal Communications Commission ("Commission") this Reply in support of the Petition Of The Connecticut Department of Public Utility Control ("Petition") filed with the Commission in the above docket.

I. INTRODUCTION.

As an initial matter, it is worth noting that other than the Bell Atlantic Metro Mobile Companies ("Metro Mobile") and Springwich Cellular Limited Partnership ("Springwich"), none of the parties ("Opponents") filing briefs in opposition to the Petition participated or appeared in the lengthy state investigatory proceedings conducted by the Connecticut Department of Public Utility Control ("Department"). As a general matter, the Opponents' various comments and Opposition Briefs demonstrate their lack of any meaningful understanding of the prevailing market conditions within the State of Connecticut. There is little or no market specific analysis on the part of the Opponents. Rather, the Opponents' comments represent, for the most part, a compendium of generalized industry arguments, pedagogical recitations of the Budget Act and Second Order and Report, and anemic assertions regarding the alleged evidentiary insufficiency of the Petition.

The Opponents' generalized opposition betrays their overall objective of seeking to obtain from the Commission what Congress refused -- a preemption of State authority. In essence, what the Opponents seek is a determination by the Commission that where it is determined that regulation is needed, it will be supplied by the Commission, and where it is not, there will be no role for any State. The Commission should decline to follow the Opponents' efforts to have the Commission end run Congress in this way.

The core inquiry for determining whether a state should be granted authority to continue its regulatory authority is unambiguous. As applicable to the Petition, the Omnibus Budget Reconciliation Act of 1993 ("Budget Act"), 47 U.S.C. § 332 provides that:

> a State may petition the Commission for authority to regulate the rates for any commercial mobile service and the Commission shall grant the petition if such State demonstrates that --
>
> > (i) market conditions with respect to such services fail to protect subscribers adequately from unjust and unreasonable rates or rates that are unjustly or unreasonably discriminatory[.]

47 U.S.C. § 332(c)(3)(A) (emphasis added).

Based on the unambiguous language of the Budget Act, the only relevant consideration is whether a State has offered sufficient evidence regarding prevailing market conditions within its state to demonstrate that it is more likely than not that, in the absence of regulation, commercial mobile service ("CMRS") subscribers will not be adequately protected from unjust or discriminatory rates. Although arguments, such as those put forth by the Opponents, may exist, Congress has chosen to leave to the states the determination of what policy choices to follow if consumers are not adequately protected from unjust, unreasonable, unjustly discriminatory or unreasonably discriminatory rates. In particular, Congress did not enact: 1) a presumption against state regulation; 2) a requirement that a state compare its market to other states' markets; 3) a requirement that the Commission find that the benefits outweigh the burdens of state regulation; or 4) a presumption that federal remedies are adequate -- all as the Opponents have argued.

Consistent with the substantive inquiry that has been mandated by Congress, the Commission adopted its Second Order and Report, In The Matter Of Implementation Of Sections 3(n) and 332 of the Communications Act Regulatory Treatment Of Mobile Services, FCC 94 -31, Gen. Docket No. 93-252 ("Mobile Service Order") and set forth a non-exclusive list of criteria which it determined would aid a State in assessing market conditions within its jurisdiction for purposes of electing whether to seek continued regulation as authorized by the Budget Act. As discussed more fully below, the Petition unquestionably satisfies the criteria established by the Commission and should, therefore, be granted. Moreover, failure to do so would constitute a complete disregard of the Budget Act's express reservation of a State's right to preserve its authority to regulate CMRS in the presence of market conditions that Congress deemed to warrant continued State oversight.

Additionally, the Department has proposed a very modest scope to its continued regulation of CMRS in Connecticut. The Department only asks for permission to continue regulating CMRS pending the conclusion of a review that is to begin on July 1, 1996, approximately one and one-half years from now. (Petition, at 5.) It does not abdicate its responsibilities under the Budget Act by proposing further investigation. Rather, it clearly indicates, consistent with the new Connecticut legislation on the subject, an intent to transition out of regulation once adequate competition appears. (Id.) Meanwhile, there is new evidence coming to light that as mass consolidations occur, there will be likely cross-ownership of various carriers that could be dominant players in the new wireless market that will emerge. In general, there is ample reason why regulation should continue during the emerging changes in the Connecticut marketplace.

II. STATE PROCEEDING HISTORY.

This State Proceeding was precipitated by a prior docket, Department Docket No. 90-08-03, wherein Metro Mobile and Springwich (collectively "Carriers") fought over whether rate regulation in Connecticut should be continued. Springwich opposed continued regulation, while Metro Mobile supported it. See Application of Springwich Cellular Ltd. Partnership for a Declaratory Ruling Re: Forbearance From Regulation of Rates of Cellular Telephone Mobile Service, Docket No. 90-08-03. The Department decided to continue regulation, without input from the Connecticut Attorney General or other consumer advocates, and without much of the evidence regarding abusive practices and excessive pricing that caused the Department to file

the Petition. Ironically, Metro Mobile now appears to criticize the very decision, to continue rate regulation, which it procured.

In any event, after being acquired by Bell Atlantic, Metro Mobile changed its position as to continued regulation and moved to reopen the decision of the Department. (Docket No. 90-08-03R.) Springwich joined in support of Metro Mobile's efforts to have regulation by the State of Connecticut stopped. In January, 1993 numerous independent Resellers joined to oppose the Carriers' deregulation efforts. The Resellers submitted persuasive evidence to the Department that the Connecticut marketplace was not fully competitive and consumers were being harmed. Soon thereafter, the Connecticut Attorney General and the Connecticut Office of Consumer Counsel ("Consumer Counsel") joined in the Resellers' opposition.

In August, 1993 the Budget Act was passed and Metro Mobile sought to withdraw its petition for deregulation. The Resellers, the Attorney General and the Consumer Counsel opposed the withdrawal and requested that the Department open an investigatory proceeding regarding market conditions in Connecticut. The parties opposing the withdrawal argued that an investigation was necessary to determine whether the consumers of the State of Connecticut would be best protected by the Department filing a petition with the Commission, thereby preserving its regulatory authority. The Department concluded that the Resellers had submitted sufficient evidence to warrant a full investigation and, therefore, ordered that one take place. (Department, Decision, Docket No. 90-08-03, dated December 15, 1993 at 3.) After the presentation of evidence the Department made findings of fact and conclusions (Department, Decision, Docket No. 94-03-27, dated August 8, 1994 ("Decision")) and, on the same date, executed the Petition now before the Commission.

In the State Proceeding, the Department found that "[t]rue competition will not exist in the CMRS market until the other wireless service providers have begun providing service and are effectively competing with the incumbent service providers." (Decision, at 30, Finding of Fact No. 6.) The Department concluded that new service providers would not enter the Connecticut market until the 1996 time frame and, moreover, would have only a minimal competitive effect during the interim period immediately following their entry into the Connecticut market. (Id., at

31, Findings of Fact Nos. 16 & 19.) Thus, the Department concluded that "[t]here are no current substitutable services for cellular service. (Id., Finding of Fact No. 15.)

The Department went on to identify several aspects of the current Connecticut situation that, in the Department's opinion merited further review and continued oversight and regulation by the Department. In support of that conclusion, the Department made the following Findings of Fact:

> 22. The role of Springwich's management on pricing decisions on the carrier's retail affiliate and independent resellers as well as its impact on the degree of competition at the retail level is questionable and should be the subject of further Department investigation.
>
> 23. Springwich has required its customers to discuss their retail rates and competitive pricing strategies with the cellular carrier which may have resulted in more favorable treatment for Springwich's retail affiliate.
>
> 24 Springwich has recently required its customers to switch their long distance carrier from AT&T to SNET America. Springwich's failure to provide for equal access conflicts with the Connecticut General Assembly and the Department's policy to promote telecommunications competition in Connecticut.
>
> 25. The disparity between the rates and charges the independent resellers currently experience for bulk wholesale cellular service when compared to that experienced by cellular carriers' retail affiliates require further review.

(Id., at 32, Findings of Fact 22-25.)

These findings, as well as the evidence presented by the Resellers -- evidence which the Department found to be "credible" (Petition, at 3) --amply demonstrates that the duopolistic Carriers are improperly exercising their market power and are restraining competition both at the wholesale and retail level. There are numerous specific findings of anti-competitive activities and abusive conduct on the part of the Carriers, all of which has had the effect of restraining the growth of a competitive marketplace within Connecticut.

In response to the Petition, Metro Mobile: 1) criticizes the Department's prior decision to continue regulation, despite the fact that that decision adopted exactly the position espoused by Metro Mobile; and 2) claims that the State Proceeding's failure to consider costs at the retail level is fatal to the Petition. As to Metro Mobile's claim

regarding retail costs, the reason that those costs were not considered by the Department was that the Carriers were successful in withholding that information from consideration. Despite the Carriers' success in avoiding disclosure of their retail costs and profits, however, there was ample evidence that Connecticut market conditions are not adequately protecting consumers and that the Budget Act's standards for continued regulation, as interpreted by the Commission in its Mobile Service Order, have been met. In short, even with numerous competitors at the retail level, the level of retail pricing in Connecticut is directly related to the level of wholesale pricing by the Carriers. For a detailed accounting of the numerous objections and arguments which were raised by the Carriers regarding the lack of relevancy of retail matters, the Commission need only review the initial two days of the transcripts from the State Proceeding. (See generally Tr., 5/13/94 and 5/16/94.)

III. STATE PETITIONS FOR CONTINUED REGULATORY AUTHORITY - RELEVANT GOVERNING STANDARD.

Under paragraph 252 of the Mobile Service Order, the Commission established that States have discretion to determine what evidence may be found to be persuasive in regard to market conditions in that State. Thus, in order to support a petition, a State may look at any number of factors. In order to aid the States in their inquiries, the Commission has set forth the general types of evidence that it will generally find pertinent to whether continued regulation is justified under 47 U.S.C. § 332(c)(3)(A). Those factors include:

> (1) The number of CMRS providers in the state, the types of services offered by these providers, and the period of time during which these providers have offered service in the state.
>
> (2) The number of customers of each such provider, and trends in each such provider's customer base during the most recent annual period . . . and annual revenues and rates of return for each such provider.
>
> (3) Rate information for each CMRS provider, including trends in each provider's customer base during the most recent annual period . . . .
>
> (4) An assessment of the extent to which services offered by the CMRS providers that the state proposes to regulate are substitutable for services offered by other carriers in the state.
>
> (5) Opportunities for new entrants that could offer competing services, and an analysis of existing barriers to such entry.

> (6) Specific allegations of fact . . . regarding anti-competitive or discriminatory practices or behaviors on the part of CMRS providers in the state.
>
> (7) Evidence, information, and analysis demonstrating with particularity instances of systematic unjust and unreasonable rates, or rates that are unjustly or unreasonably discriminatory, imposed upon CMRS subscribers. Such evidence should include an examination of the relationship between rates and costs. The FCC will consider especially probative the demonstration of a pattern of such rates, if it also is demonstrated that there is a basis for concluding that such a pattern signifies the inability of the CMRS marketplace in the state to produce reasonable rates through competitive forces.
>
> (8) Information regarding customer satisfaction or dissatisfaction with services offered by CMRS providers, including statistics and other information regarding complaints filed with the state regulatory commission.

Mobile Service Order at paragraph 252. The Petition and Decision address these criteria in particularity. The conclusions and presentation of the Department are amply supported by the evidence presented in this matter.

IV. EVIDENTIARY SUFFICIENCY.

In general, the Petition and the Decision demonstrate with certainty that market conditions within the State of Connecticut fail to adequately protect consumers from unreasonable and unjust rates. In the presence of minimal regulation, the Carriers have engaged in abusive conduct and there would be little logic in abandoning regulation in the hope that uncertain future competition will correct the Carriers' behavior during the period of transition to a fully competitive market place. The evidence presented to the Department eminently supports its conclusions in regard to each of the Commission's suggested criteria.

1. Factor (7) - Evidence, Information, and Analysis Demonstrating with Particularity Instances of Systematic Unjust and Unreasonable Rates, or Rates that are Unjustly or Unreasonably Discriminatory, Imposed upon CMRS Subscribers.

The record of the State Proceeding contains demonstrable evidence that the rates charged by the Carriers are excessive in relation to their prudent costs, and that this circumstance has been prevailing and continues to prevail. This circumstance is, a fortiori, a case of systematic unjust and unreasonable rates. The Department had

before it evidence of: a) anticipated future declines in the Carriers' prices due to additional competition; b) excessive rates of return by the Carriers; c) significant market concentration and minimal price competition; and d) billing for unused services.

a. Expected Decline in Prices Upon Increased Competition.

The most striking and credible evidence that rates are excessive is the direct and repeated testimony of every one of the Carriers' witnesses during the State Proceeding that they expect cellular prices to fall on the order of 25% with the presence of new competition in Connecticut. In fact, there are numerous instances where witnesses for the Carriers testified that prices will fall in the future due to competitive pressure from PCS and ESMR: 1) Brennan (Transcript ("Tr."), 5/13/94 at 251)(When entrants come in "it's going to put pressure on rates in the market"); 2) Hausman (Tr., 5/16/94 at 435)("[Reseller] claims on ESMR that they cannot compete are wrong. Cellular prices in Los Angeles have already decreased by 17 per cent . . . ."); 3) Schulman (Tr., 5/16/94 at 453-55)("I think that you will see plans that address the competitive forces coming from all the participants . . . . I believe that over time as new competitors come on-line, there will be increased pressure on the downward trend of pricing . . . ."); 4 Hausman (Tr., 5/16/94 at 489)("I expect prices to fall somewhere in the order of 25 per cent or so over the next years as the ESMR and PCS comes in."); 5) Hausman (Tr., 5/16/94 at 490)("competition" will determine level to which prices will fall.); 6) Hausman (Tr., 5/16/94 at 526)(Price constraints created by "the two competitors and the desire to grow, and of course, as soon as Nextel and the PCS comes in, that will be primary constraints as well on prices."); 6) Hausman (Tr., 5/16/94 at 554 & 604)(Cellular industry is offering "a lot more packages tailored for different groups and consumers, so I expect the use to go up more in the future and I expect the prices of these packages to come down as well."]; 7) Schulman (Tr., 5/20/94 at 681, 682, 685 & 686)("there will be a downward trend on the pricing, and it definitely could be to the order of twenty-five percent over time."); 8) Schulman (Tr., 5/20/94 at 707)(Twenty-five percent reduction in prices could represent "if we are talking on a grand enough scale . . .millions of dollars . . . ."); 9) Brennan (Tr., 6/7/94 at 1214)("Prices will continue to fall, further driven by entrance pricing for entry."); 9) Schulman (Tr., 6/7/94 at 1215, 1263, 1541 & 1542)("I believe that typically competition leads to downward pressure on pricing and we would have to rethink our pricing scenarios."). **[Confidential and Proprietary Information Redacted for Public Version]**. Late File Exhibit 3 is particularly persuasive since it was prepared

in the due course of business and, thus, represents an untainted assessment by the Carriers of the impact of future competition on prevailing market prices.

After offering repeated testimony that prices will fall because of additional competition from Nextel and PCS, the Carriers attempted "damage control" in the closing days of the hearing by attempting to explain future price drops as a function of increased efficiency and reduced operating costs. (Tr., 6/7/94 at 1519.) Besides being contrary to their repeated testimony that they expected future significant price declines because of new competition from Nextel and PCS, the Carriers' own revenue projections undermined the credibility of their last minute explanation.

The anticipated substantial decline in prices due to additional competition is significant for two reasons. First it shows that the prevailing service prices charged by the Carriers exceed the price that would prevail in a more competitive market. Second, it shows that effective price competition does not currently exist in Connecticut and flatly contradicts the Carriers' assertions that they have been engaging in vigorous competition lo these many years. To the contrary, an anticipated drop of 25% in response to additional competition is strong, if not conclusive, evidence that the Carriers have not engaged in any price competition. Therefore, consumers have been charged and are paying excessive prices under current market conditions, and it cannot be said that market conditions are adequately protecting consumers.

b. Excessive Rates of Return.

Other evidence confirming that prevailing cellular prices are excessive relate to the rate of return and financial information submitted by the Carriers. As the Department correctly observed, "the Cellular Carriers have been earning what appears to be excessive RORS(s) throughout most of the period [1988-1993]." (Decision at 10.) Specifically, the evidence reveals a story of excessive wholesale prices that is consistent with the anticipated future decline of prices as competition enters the market place. Based on information reported in the Carriers' own financial statements under TE-3, the data response to TE-17, and Late Filed Exhibits 3 and 4, it was determined with a minimum of appropriate adjustments that the Carriers' rates of return, on a conservative basis, ranged from **[Confidential and Proprietary Information Redacted for Public Version]**% in 1988 to nearly **[Confidential and Proprietary Information Redacted for Public Version]**% in the most recent full

year for Springwich and, in the case of Metro Mobile, in the range of **[Confidential and Proprietary Information Redacted for Public Version]**% to nearly **[Confidential and Proprietary Information Redacted for Public Version]**% through the years 1990 to 1994. (See Late File Exhibits 38, 39, 40 and 41 (King and Lee Financial Analysis Sheets), and Revised Late File Exhibits 38 and 39 attached hereto as Exhibit A (Non-Public).)[1]

Although the evidence presented allowed the Department to conclude that there appears to have been excessive rates of return, the Department also recognized the need for further investigation. This was consistent with the Resellers' position that inadequate accounting guidelines were available to distinguish between wholesale and retail costs under the Carriers' consolidated wholesale/retail bookkeeping methods. Thus, the Resellers claimed that there was a substantial risk that the data supplied by the Carriers, on which the parties and the Department was forced to rely, understated the Carriers' true rate of return.

The evidence that rates of return of the Carriers are excessive is entirely consistent with the anticipated 25% rate reduction which the Carriers predict will occur in the future with new competitors. (Tr., 6/7/94 at 1472-3)(King observing that "**[Confidential and Proprietary Information Redacted for Public Version]** . . . .")

The Department's finding regarding apparent excessive rates of returns is further supported by comparing those returns with the "reported" returns of the Carriers and with other market evidence. (See Late File Exhibits 16 and 36; Tr., 6/7/94 at 1383 (Hausman asserting that Metro Mobile's returns for 1991, 1992, 1993

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[1] Exhibit A contains revised Lee/King financial calculations which account for AFUDC for both Carriers, and an effective tax rate adjustment for Springwich from 25% to 30%. All references to LFE 38 and 39 shall mean LFE 38 and 39, as subsequently revised by Exhibit A. Also attached as Exhibit B is a Statement of Tax Adjustment from Lee. The Statement explains the methodology employed in making the tax adjustment, which was based on the Southern New England Telecommunications Corp. 1992 Annual Shareholders Report. In each case, these adjustments were made in response to specific criticisms of the Carriers regarding a failure to provide for AFUDC and the allegedly improper use of SNET's reported tax rate to the FCC. See, Tr., 6/7/94 at 1490 and 1492

are **[Confidential and Proprietary Information Redacted for Public Version]**%, respectively); Late File Exhibit 33 (Springwich rates of returns calculated by Hausman at **[Confidential and Proprietary Information Redacted for Public Version]**%); see also Late File Exhibit 38 and 39 (Lee/King calculations of "reported" returns).) The reported returns are **[Confidential and Proprietary Information Redacted for Public Version]**.

Although the Department did not reach a specific conclusion as to the appropriate rate of return, the evidence submitted casts very substantial doubt on the claim of Dr. Hausman, the Carriers' expert witness, that based on his capital asset pricing model, the proper and needed rate of return for cellular companies is 20.7%. (See Late File Exhibit 32 and Tr., 6/7/94 at 1232.) In fact, Hausman asserted that in order to successfully raise capital "the stock market is saying [demands] 20.7 % to be exact," (Tr., 6/7/94 at 1315), and that the actual cost of equity for Springwich "**[Confidential and Proprietary Information Redacted for Public Version]** . . . ." (Tr., 6/7/94 at 1315-16.) The problem with this assertion is that Bell Atlantic paid over $200 per pop on such allegedly **[Confidential and Proprietary Information Redacted for Public Version]** returns and witnesses for both Carriers have testified that they have and will continue to make substantial investments in their systems. The fact that capital is successfully flowing into the Carriers for expansion quickly undermined this contention.

The rate of return calculations presented by the Resellers was based upon a methodology similar to that which the Commission uses. (Tr., 6/7/94 at 1449.) Moreover, the Department implicitly concluded that a meaningful rate of return inquiry required that certain adjustments be made in order to assess the appropriateness of the rates from the rate payer's perspective.. First, appropriate rate base adjustments for CWIP, and an allocation for AFUDC at a rate of 15%, were made. (Exhibit A to Non-Public Brief, Revised Late File Exhibits 38 and 39; Tr., 6/7/94 at 1508-09 (Lee presents results of AFUDC calculations in response to cross examination by Knickerbocker).) The CWIP adjustment was necessary in order to minimize the adverse economic effect from the rate payer perspective of including non-productive assets in the rate base. The appropriateness of this adjustment is evidenced by the fact that at any one time a **[(a significant) Confidential and Proprietary Information Redacted for Public Version]** percentage of plant is not in use. In the case of Metro Mobile, the percentage is in the range of **[Confidential and**

Proprietary Information Redacted for Public Version]% of total plant compared with an average of 2% in the case of local exchange carriers. (See Tr., 6/7/94 at 1484.)

Additionally, rather than using the fictional marginal tax rates proposed by the Carriers' expert, Dr. Hausman (Late File Exhibit 36; and Tr., 6/7/94 at 1271), an effective tax rate was employed which is based on the amount of taxes actually paid in the case of Metro Mobile. (See Late Filed Exhibit 37.) In the case of Springwich, the effective tax rate of its regulated affiliate was initially used because Springwich is a partnership and it pays no tax at the partnership level. (See Initial Late File Exhibits 38 and 39.) In response to criticism from the Carriers, the effective tax rate as reported in the annual shareholders report of Southern New England Telecommunications Corp., an affiliate of Springwich, was employed. (See Revised Late File Exhibit 39; and Exhibit B to Non-Public Brief, Statement of Tax rate Adjustment of Lee.)

The use of effective tax rates was relevant to the tax considerations from the rate payer perspective. The Carriers unsuccessfully argued in the State Proceeding that marginal rates should be employed because Springwich is a partnership and all debt deductions are "already used up" at the parent level, thus the income is not offset by deductions. (See Tr., 6/7/94 at 1271.) The problem that the Department recognized was that it would have been artificial to not examine such a case on a consolidated basis and apportion taxable items accordingly. Furthermore, the Carriers admitted that no regulatory body treats taxes in the fashion in which they attempted to have them treated in the State Proceeding. (Tr., 6/7/94 at 1273-74.)

The third adjustment that was made for purposes of calculating rates of return was an adjustment for good will. (See Tr., 6/7/94 at 1499-1500.) Again, Springwich paid nothing for its cellular license and Bell Atlantic paid Metro Mobile $202 per pop for a system which was valued, according to Hausman, in Metro Mobile's "highest year" at $[**(multiples lower) Confidential and Proprietary Information Redacted for Public Version**]. (See Metro Mobile Financial Statements.) Whether or not the amortization period is appropriate, the issue the Department recognized was whether it was just for rate payers to be subsidizing the leveraging of an allegedly scarce resource (i.e., spectrum) through corporate acquisitions. Again, the Department implicitly agreed with the Commission's own methodology wherein the FCC has

eliminated the excess acquisition cost over the book value from the rate base to avoid the abuse of a continual spiraling effect in the market values of systems through repeated acquisitions. (See Tr., 6/7/94 at 1499-1500.)

Finally, both Carriers were subject to one specific adjustment. In the case of Metro Mobile, the adjustment impacted the 1994 and 1995 rates of return. This adjustment increase anticipated that Metro Mobile's revenues would be consistent with more recent actual reported monthly revenues rather than earlier revenue projections and reconciled future revenues with historically experienced revenues. (See Tr., 6/17/94 at 1465; Late File Exhibit 38; and Tr., 6/7/94 at 1506 (Lee identifies discrepancy between earlier filed LFE 15 of projected revenues with subsequent report of actual monthly revenues in LFE 29).) The appropriateness of this adjustment was confirmed by Metro Mobile when it provided monthly revenue information. (See Late File Exhibit 29; and Tr., 6/7/94 at 1527-29.)

With respect to Springwich, an adjustment was made to put Springwich's reported expenses **[(in line with Metro Mobile) Confidential and Proprietary Information Redacted for Public Version]**. Moreover, Springwich is a shell entity with all retail and wholesale activities actually occurring through the unregulated retail affiliate, therefore giving credibility to the conclusion that improper cost allocations were occurring. (See, infra.) In the alternative, if Springwich's costs were in fact as high as claimed, the consumers should not be required to pay for such costs to the extent they exceeded what was reasonable. Also, substantial testimony was given by Mr. Schulman of Metro Mobile **[(regarding cost allocation) Confidential and Proprietary Information Redacted for Public Version]**.

The suggestion made by the Resellers, the Attorney General and the Consumer Counsel, (Decision, at 10), that 15% was a reasonable rate of return is appropriate and reasonable in light of the evidence presented to the Department. First, the California Public Utilities Commission held that 14.75% is the appropriate return for cellular carriers. (Ca. PUC, Decision, Docket No. 92-10-026 (No recession under Ca. PUC, Decision , Docket No. 93-05-069.) Also, the Department in its Decision in Docket No. 92-09-19 found that the First Boston DCF analysis for determining imputed value of cellular holdings for SNET persuasive. (Department Decision, Docket No. 92-09-19, at 124.) Specifically, First Boston determined that 12.8% was the necessary rate of return for the cellular industry using a discount cash flow analysis. (Docket 92-09-

19, OCC-49, Attachment A- First Boston, The Future of the Cellular Telephone Industry at 5 (Dec. 1991).) Similarly, Donaldson, Lufkin & Jenrette employ discount rates of 12% and 15% in their valuation models . (Resellers Response TE - 14, Donaldson Lufkin & Jenrette, The Wireless Communications Industry, at 40 and Table 5 (Winter 1994).) Pitsch also adopted 15% as an appropriate rate of return in his discounted cash flow study. (Resellers Coalition Response to TE-14, Pitsch, The State of Competition in the Cellular Industry, at 17 et seq. (June 21, 1993).) Also, the Attorney General introduced reported authorized returns on equity by PUCs since 1984 as published by Regulatory Research Associates. (Late File Exhibit 35.) Again, a rate of return of 15% is even more generous in comparison to the authorized rates reported in RRA. Even Hausman, the Carriers' expert, admitted under cross examination that a proper rate of return would be 16.2 % **[Confidential and Proprietary Information Redacted for Public Version]**. (See Tr., 6/7/94 at 1238.)

The only evidence presented that 15% was not a reasonable and proper rate of return for cellular operations was the opinion of the Carriers' witness, Dr. Hausman, who opined that based on his capital asset pricing model, 20.7% was a proper return for cellular companies. (Late File Exhibit 32.) In developing this figure, Hausman used a highly leveraged company, McCaw Communications, with a corresponding high "beta." It was revealed that other cellular companies with much lower "beta(s)" could have been used. (See Tr., 6/7/94 at 1336.) In fact, the Attorney General identified at least five cellular companies with substantially lower betas in Value Line. The high beta coefficient that Hausman adopts as characteristic of the industry was shown to be tied to a very risky capital structure of a highly leveraged company, rather than to a non-diversifiable risk. (See Tr., 6/7/94 at 1467.) Furthermore, the Carriers' assertion that the high price of cellular is justified by scarcity of rents (that is that spectrum is a limited resource and, therefore, demands a high price) contradicts their contention regarding the appropriate rate of return, because common sense dictates that if the carriers are beneficiaries of a limited and finite resource, then the non-diversified risk associated with engaging in selling that resource would be lower. On the demand side, there is no question that there is more than enough demand for this resource, as evidenced by the annual subscriber growth rates of 30% and more.

In view of the extensive financial evidence and thorough consideration undertaken by the Department, the Opponents' suggestion that past excessive rates of return are not significant constitutes a disregard of the specific criteria that the

Commission suggests should be addressed in petitions. Similarly, suggestions that regulation would yield rates that would be too low to be "efficient" begs the question of what a reasonable rate of return should be. Additionally, the suggestion that accounting rate of return is inappropriate because of replacement costs overlooks the fact that the Carriers' were allowed by the Department to select their own write off periods.

c. Significant Market Concentration and Minimal Price Competition.

Other evidence supporting the existence of excessive prices include: (1) market concentration and HHI market analysis (see, infra), (2) pricing history (see, infra), and (3) the Carriers argument that advance notice has stifled price competition between them (see, infra).

d. Billing for Unused Services.

Perhaps the most obvious evidence of excessive and systematic unjust rates is the Carriers' practice of charging and billing for services not actually used by the consumer since the inception of cellular service in Connecticut. The essence of this abusive practice is that the Carriers bill air time in rounding conventions of one minute, for Springwich, (see Written Testimony of Jan Mizeski, 5/6/94 at 198), and currently one minute for the first minute and 30 seconds thereafter, for Metro Mobile. (See Decision, at 25; and Written Testimony of Jan Mizeski, 5/6/94 at 3.) This convention is used despite that fact that the Carriers have the ability and do record call durations in increments of 1/10th of a second. (See Tr., 6/3/94 at 937; and Written Testimony of Jan Mizeski, 5/6/94 at 3.)

Under this practice, time usage is rounded up to the next full minute, such that a call that has an actual duration of 1.01 minutes is charged as a 2 minute call. In this example, the effective cost of the phone call is 100% higher than the actual tariff rate. This problem is also compounded by successive calls, because the one minute rounding convention leads to overlap calls, such that the consumer is billed twice for the same minute. In the case of Metro Mobile, although its one minute billing convention was changed to a 30 seconds, the same problem exists with consumers being overcharged through the rounding convention. (Tr., 6/3/94 at 962; and Late Filed Exhibit 22.) Similarly, consumers using long distance service over their cellular phones are billed in one minute increments. (See Written Testimony of Jan Mizewski,

5/6/94 at 5.) However, long distance calls are recorded and billed at the wholesale level in increments of one-tenth of a minute. (See Read-In A, at 175.)

The amount of losses that consumers have experienced as a result of this inexcusable and unjustified practice can only be speculated. The Carriers argue that the practice is justified because that is what the tariffs authorized. But, as the Carriers admitted, there is no technological reason why they could not bill in smaller increments. (Tr., 5/13/94 at 199.) In fact, Springwich received authority to bill in 30 second increments in 1987, (Docket 87-10-23), but chose not to do so. (Tr., 5/13/94 at 197-199.) Further, the Carriers have had this capability to change the billing interval since the inception of cellular. (See Tr., 5/16/94 at 333.)

The fundamental point embraced by the Department is that if there were vigorous competition in the Connecticut market, this type of practice would yield to consumer buying pressure. This point was driven home by Springwich during the State Proceeding. Thus, the following colloquy took place:

> Rosario (Attorney General): "it is possible to for you to alter your billing interval, is that correct?"
>
> Bluemling (Springwich): "I guess it's been possible for some time but it would affect revenues."

(Tr., 5/16/94 at 333.) Although the Carriers rely on the fact that the Department approved tariffs included this and other unfair practices, their reliance just confirmation of the monopoly power of the Carriers, and their ability in the past to deter challenges to them before the Department.

2. Factor (3) - Rate Information for each CMRS Provider, Including Trends in each Provider's Customer Base During the Most Recent Annual Period.

Again, the most telling evidence that prevailing rates are not subject to vigorous competition is the prediction that prices will decline by 25% when additional competition enters the market. Further evidence of the lack of competition in Connecticut is that both retail arms of the Carriers have had the same basic pricing of $38 and 38 cents per minute since the inception of cellular service in Connecticut. (Tr., 5/12/94 at 90 & 5/16/94 at 449-50.) In the case of Springwich's affiliate, the same basic plan price has been in force since 1984. (See Tr., 5/12/94 at 90.) In the

case of Metro Mobile's retail division, the same basic plan price has been in force since 1987. (Tr., 5/16/94 at 450.)

There are several matters that make this basic plan history particularly telling in regard to the lack of competition in the Connecticut market. First, other retail pricing plans have emerged in order to accommodate customer use characteristics. The Carriers emphasize this as a mark of price competition but, in reality, it reveals the static nature of cellular prices. The Carriers assert that the numerous retail rate plans that have changed are designed to make sense for particular groups of consumers with certain usage characteristics. (Tr., Tr., 5/12/94 at 92 & 5/16/94 at 450-51.) In essence, consumers with usage characteristics that best fit the Carriers' basic retail pricing plans have not seen a price reduction in a decade. The economic expert for the Carriers also revealed that there is only a marginal cost savings for consumers who use a "non-standard" plan. As Dr. Hausman testified in the State Proceeding, there is only a "couple of bucks" difference between the basic plan and Metro Mobile's $89.95 rate plan, on an average monthly customer bill of $93. (Tr., 5/16/94 at 537.)

If anything, the multiple retail price plans are nothing more than a discriminatory pricing tool, designed to maximize revenue per subscriber by price discriminating among consumers' use habits. This premise is further supported by three key facts: 1) there is no meaningful wholesale/retail distinction for the Carriers; 2) the same individuals are involved with setting retail and wholesale prices; and 3) the Carriers' retail arms control in excess of 90% of the retail market. The wholesale pricing history of the Carriers is similarly telling. At best, the evidence leads to the conclusion that there has been little or no pricing competition since 1987. In the case of Metro Mobile, from the inception of its service in 1987 until August 1993 there was no change in the fundamental price components of cellular service -- the monthly access charge and per minute usage charge. (Metro Mobile Interrogatory Response to TE-2; and Tr., 5/16/94 at 455-56.)

Coincidentally, Metro Mobile's wholesale price change occurred at the time hearings were scheduled in the Department's Docket 93-08-03, in which Metro Mobile was petitioning for deregulation and was encountering stiff opposition from the Resellers! (See Tr., 5/16/94 at 461.) For Springwich, three quantifiable, permanent access and per minute rate changes from 1987 through August of 1993 were identified. In total, the permanent changes amounted to a $1 reduction in access

rates and a 5 cent reduction in per minute charges. In September of 1993, Springwich responded to the August 1993 Metro Mobile wholesale change. (Id.)

The Department also chose to ignore Springwich's claim that cellular prices have fallen 40%. (See Written Testimony of Jerome Brennan, 5/6/94- Exhibit JPB-7; and Tr., 5/12/94 at 53.) The Carriers assertion was based on the fact that the monthly average bill per subscriber has fallen. That fact had nothing to do with the Carriers or competition, however, because the drop in monthly bills was attributable to the simple fact that average airtime use by consumers has decreased as the gross number of subscribers has increased. In fact, the Carriers confirmed this phenomena of a continuing pattern of fewer and fewer minutes because of new low use subscribers. (See Tr., 5/12/94 at 95.) Also, the Cellular Telecommunications Industry Data Survey confirms that the average monthly bill has declined across the United States, from $96 to $57, since June of 1987. (See Resellers Response to TE-14 (Donaldson, Lufkin & Jenrette, The Wireless Communications Industry at 8).)

3. Factors (4) and (5) - An Assessment of the Extent to Which Services Offered by the CMRS Providers that the State Proposes to Regulate are Substitutable for Services Offered by Other Carriers in the State and Opportunities for New Entrants that Could Offer Competing Services, and an Analysis of Existing Barriers to Such Entry.

The Department correctly determined that the Connecticut market was and will continue to be extremely concentrated. (Decision, at 18.) Based on the record, the Carriers are the only providers of mobile telephone service on an interconnected basis in the State of Connecticut. The Carriers argued that a plethora of competitors offered substitute services in the Connecticut market. (See Written Testimony of Jerome Brennan, 5/6/94 at 6-9, Exhibit JPB -1 and 2.) Specifically, it was argued that paging services and SMR services are substitutes for cellular service. Id. Contrary to these assertions, however, the Department specifically found "that there are no current substitutable services for cellular service." (Decision, at 18.)

Paging is vastly inferior to cellular because paging does not offer two-way voice communications. (See Resellers' Response to TE-11; and Tr., 5/20/94 at 816 & 5/13/94 at 328.) Furthermore, the combination of paging with landline telephone service does not offer the essential features of cellular, which is immediate,

transportable mobile communications. (See Tr., 5/20/94 at 875.) Similarly, SMR service is not a substitute because it is essentially a closed network for fleet dispatch and interconnection to the public switched network is generally not available. (See Resellers Response to TE-11; and Tr., 5/20/94 at 856 & 870.)

The lack of substitutability of these other services was admitted by the Carriers' own witnesses. (See Tr., 5/13/94 at 329.) Further, the record reveals that the existence of these services has placed minimal pricing pressure on cellular market prices. (See Tr., at 525-26.) Finally, the most indicting evidence against substitutability comes from the Carriers' own expert economist's HHI calculation. At no time did Dr. Hausman deem it appropriate to include other existing wireless services in his market concentration calculations. (See Late File Exhibit 13.) Not surprisingly, the Carriers offered no evidence that other existing wireless providers in Connecticut exerted any competitive forces on the cellular market. Additionally, no offering was made by the Carriers regarding the total number of subscribers using SMR, RAM or ARDIS in Connecticut, because the market penetration of those services is infinitesimal in comparison to the approximately 200,000 cellular customers in Connecticut. (See Late File Exhibit 3, and Carriers' 1993 Semi-annual Reports of Record.)

The lack of substitutable services and lack of competitive market forces from other existing service providers is also probative as to the lack of competition in the Connecticut market sufficient to adequately protect consumers. This point was also corroborated by the Carriers' own expert, Dr. Hausman, who opined that the major constraint on cellular prices will come in the future from Nextel and PCS competition, rather than any current service, such as paging or SMR. This is also remarkably consistent with the Carriers' predictions of future price decreases of 25% once PCS and Nextel arrive and become competitive in Connecticut.

The Department also correctly found that Herfindahl-Hirschman Index ("HHI") analysis of the Connecticut market provided insight, because the HHI showed that the Connecticut market has been and continues to be "highly concentrated" according to the Department of Justice and Federal Trade Commission guidelines. (Decision, at 18; see Written Testimony of Peter Pitsch, 5/21/93 at 6 and 9.) Calculating the HHI on market shares, the following was found:

YEAR	HHI	Market Concentration
1993	5032	Highly Concentrated
1992	5020	Highly Concentrated
1991	5,001	Highly Concentrated
1990	5,004	Highly Concentrated
1989	5,032	Highly Concentrated
1988	6,012	Highly Concentrated
1987	10,000	Highly Concentrated

(Tr., 5/16/94 at 626-27 & 633.)

Since the inception of cellular service in Connecticut, the structure of the Connecticut market has shown the potential for serious anti-competitive behavior under HHI analysis. (See Tr., 5/16/94 at 631-32.) In fact, as discussed infra, there has been a pattern of systematic anti-competitive conduct by the Carriers, which is consistent with the potential danger of anti-competitive activity recognized in "highly concentrated" markets. Similarly, the potential for anti-competitive behavior will continue into the future, during the transition from a duopoly market to a multi-competitor market. Using Personal Communications Industry Association forecasts, the Resellers calculated an HHI range of 2,464 to 2,593 for 1998 based on minimum and maximum market concentrations with PCS, ESMR and Satellite. (See Written Testimony of Charles W. King, 5/6/94-Table 2.)

Only in 2003 does the projected HHI dip below the "highly concentrated" level, and, then, only under the minimum market concentration scenario. (See Decision, at 18.) The concern about future Connecticut market conditions during the transition period takes on greater significance when viewed in conjunction with the Carriers' own market share projections. (See Late File Exhibit 3 (market assumptions).) Springwich's in-house financial analyst predicts market shares of **[Confidential and Proprietary Information Redacted for Public Version]**% and **[Confidential and Proprietary Information Redacted for Public Version]**% for Metro Mobile and Springwich in 1999 for the least concentrated market concentration scenario. (Tr., 6/7/94 at 1256-1264, and Late File Exhibit 3.) Under the Carriers' most competitive future market analysis, and assuming the most possible market fragmentation, the HHI would still be highly concentrated. (Tr., 6/7/94 at 1553-55.)

The Carriers argued that the HHI for the Connecticut market is between **[Confidential and Proprietary Information Redacted for Public Version]**. (See Late File Exhibit 13.) The Carriers' calculations were not based on market shares but, rather, on spectrum capacity, which was a self-serving interpretation of the FTC/DOJ guidelines. (See Tr., 6/46/94 at 427.) These Guidelines list three alternatives for calculating HHI, and capacity is not appropriate. (See Tr., 5/20/94 at 735.) Furthermore, on a forward looking basis, spectrum is not the constraining factor on capacity because the Commission has authorized 120Mhz of additional spectrum. (See Tr., 5/20/94 at 735.) The self-serving nature of the Carriers' HHI analysis was demonstrated in that Dr. Hausman, when testifying on the other side of this issue in the long distance arena, used share of minutes for a market with three competitors- not capacity. (See Tr., 5/16/94 at 509; and Late File Exhibit 12.) Using Hausman's share-of-minutes approach to the Connecticut market, the HHI was still found to be approximately 5,000. (Tr., 5/16/94 at 509-10.) Finally, the quality of the Carriers' HHI analysis became highly questionable in light of all the other evidence in the record of the State Proceedings. In particular, evidence that prices will decline 25% with additional competition and that the constraining price factor in the Connecticut market is the future competition from PCS and ESMR, rather than any existing alternative service providers.

Contrary to McCaw's assertions regarding the propriety of the Department relying on HHI analysis, the Department clearly stated that the HHI evidence offered "some insight as to the degree of competition in the marketplace." (Decision, at 18.) As stated above, the HHI evidence corroborated a substantial body of other evidence regarding the level of competition in the marketplace. Further, McCaw's argument that HHI is not relevant because it is employed in merger and business combination contexts by the DOJ and FTC is absurd. Certainly if HHI analysis is relevant in the antitrust context because it is probative as to the potential harm that can result from a business combination, it is equally probative in other market concentration inquiries, irrespective of the forum of the inquiry.

4. Factor (6) - Specific Allegations of Fact . . . Regarding Anti-Competitive or Discriminatory Practices or Behaviors on the Part of CMRS Providers in the State.